Congressional Research Service
Informing the legislative debate since 1914

INSIGHT

Recent Mortgage Pricing Directive for Fannie Mae and Freddie Mac

Updated June 7, 2023

Introduction

The Federal Housing Financing Agency (FHFA) directed Fannie Mae and Freddie Mac to revisit the fees applied to guarantee mortgage default risk. As primary regulator and conservator of Fannie Mae and Freddie Mac, FHFA announced this directive as part of the strategic plan to improve the financial conditions of Fannie Mae and Freddie Mac. This Insight explains how the new pricing directive works, particularly for borrowers at low-default risk relative to those at high-default risk.

The New Price Adjustment Structure

Fannie Mae and Freddie Mac, two government-sponsored enterprises (GSEs), were chartered by Congress in 1938 and 1970, respectively, to provide liquidity for both the single- and multi-family mortgage markets. In the years following the housing and mortgage market turmoil beginning in 2007, the GSEs experienced financial difficulty. On September 6, 2008, FHFA took control of them from their stockholders and management in a process known as conservatorship. FHFA has since implemented various initiatives, referred to as strategic plans or scorecards, to improve the GSEs' financial conditions, which can facilitate their exit from conservatorship. The GSEs are now being allowed to accumulate capital reserves to buffer against mortgage default risks.

The ability to accumulate capital to exit conservatorship depends upon the premiums that Fannie Mae and Freddie Mac can charge for insuring against mortgage default risk. When determining the interest rate for a single-family mortgage—and ultimately the premium that would be retained by Fannie Mae and Freddie Mac—a loan originator typically receives a *rate sheet* from Fannie Mae or Freddie Mac with a designated minimum base rate and the various risk adjustments, referred to as the loan-level price adjustments (LLPAs), which are subsequently added to the base. After gathering the mortgage applicant's credit score and down payment amount, the lender can go to the LLPA matrixes to locate the corresponding fees that are added to the base rate. For loans such as a cash-out refinances or investment properties, which may be associated with higher default risk or are not directly related to the policy goal of increasing homeownership, respectively, additional LLPA fees may be attached.

Congressional Research Service
https://crsreports.congress.gov
IN12151

As conservator, FHFA directed Fannie Mae and Freddie Mac to alter their LLPA structures effective on May 1, 2023 (and also rescinded an LLPA fee that would have been based on debt-to-income ratios). Their new LLPA fee structure shows that borrowers with low-default risk will generally pay less than those at high-default risk. Some low-default risk borrowers, however, may pay more under the new fee structure. An example is provided in **Table 1**. A prospective low-risk borrower with a credit score between 760 and 779 and a down payment in the range of 15%-20% would have an LLPA of 0.625% added to the base mortgage rate under the new structure, compared to 0.250% under the previous structure. By contrast, a prospective high-risk borrower with a credit score between 640 and 659 and a down payment in the range of 15%-20% would have an LLPA of 2.250% added to the base mortgage rate under the new structure, compared to 2.750% under the previous structure.

Table 1. Comparison of Previous and New LLPA Structure

Assumes a Down Payment in the Range of 15%-20%

	Previous LLPA Structure	New LLPA Structure
Low-Risk Borrowers	0.250%	0.625%
High-Risk Borrowers	2.750%	2.250%

Source: Fannie Mae. The new LLPA structure is hyperlinked in the text.

Comparisons of the previous and new LLPA grids show that low-risk borrowers currently pay higher LLPAs, and high-risk borrowers currently pay slightly lower LLPAs. When making comparisons on the same fee structures, however, low-risk borrowers will generally pay lower LLPAs compared to high-risk borrowers to compensate for their elevated levels of default risk. (Further pricing differentials occur if additional LLPAs are incorporated to account for mortgage characteristics that differ and are considered riskier compared to the traditional 30-year fixed rate mortgage.)

FHFA's LLPA pricing directive could arguably serve multiple policy objectives. For example, low-risk borrowers may subsidize some of the costs to insure against the default risk of borrowers with low credit scores, which may be one policy objective. In addition, a larger share of revenues collected from low-risk borrowers may expedite the GSEs' ability to accumulate more retained earnings necessary to exit conservatorship, thus serving a different policy objective. Charging high-risk borrowers slightly lower premiums could potentially increase affordability and promote more stable payment behavior from this group, possibly increasing the amount of revenues that could also facilitate earlier exit from conservatorship. Given that fewer high-risk borrowers may qualify for as many or for mortgages as large as those obtained by low-risk borrowers, more of the revenues collected under the new LLPA schedule are likely to be applied toward improving the financial conditions of Fannie Mae and Freddie Mac.

H.R. 3564, the Middle Class Borrower Protection Act of 2023, would require Fannie Mae and Freddie Mac to revert to the previous fee schedule. After expiration of a temporary prohibition period, the FHFA Director may propose adjustment to the single-family pricing framework following procedures consistent with the Administrative Procedure Act (rather than the scorecards).

Author Information

Darryl E. Getter
Specialist in Financial Economics

Disclaimer